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Supreme Court of the United States.

OCTOBER TERM, 1903.

NO. 90.

THE NEW YORK COUNTY NATIONAL BANK,

Appellant,

against

ALBERT P. MASSEY, AS TRUSTEE IN BANKRUPTCY OF GEORGE H. STEGE AND FREDERICK H. STEGE,

Appellee.

Brief for Appellee.

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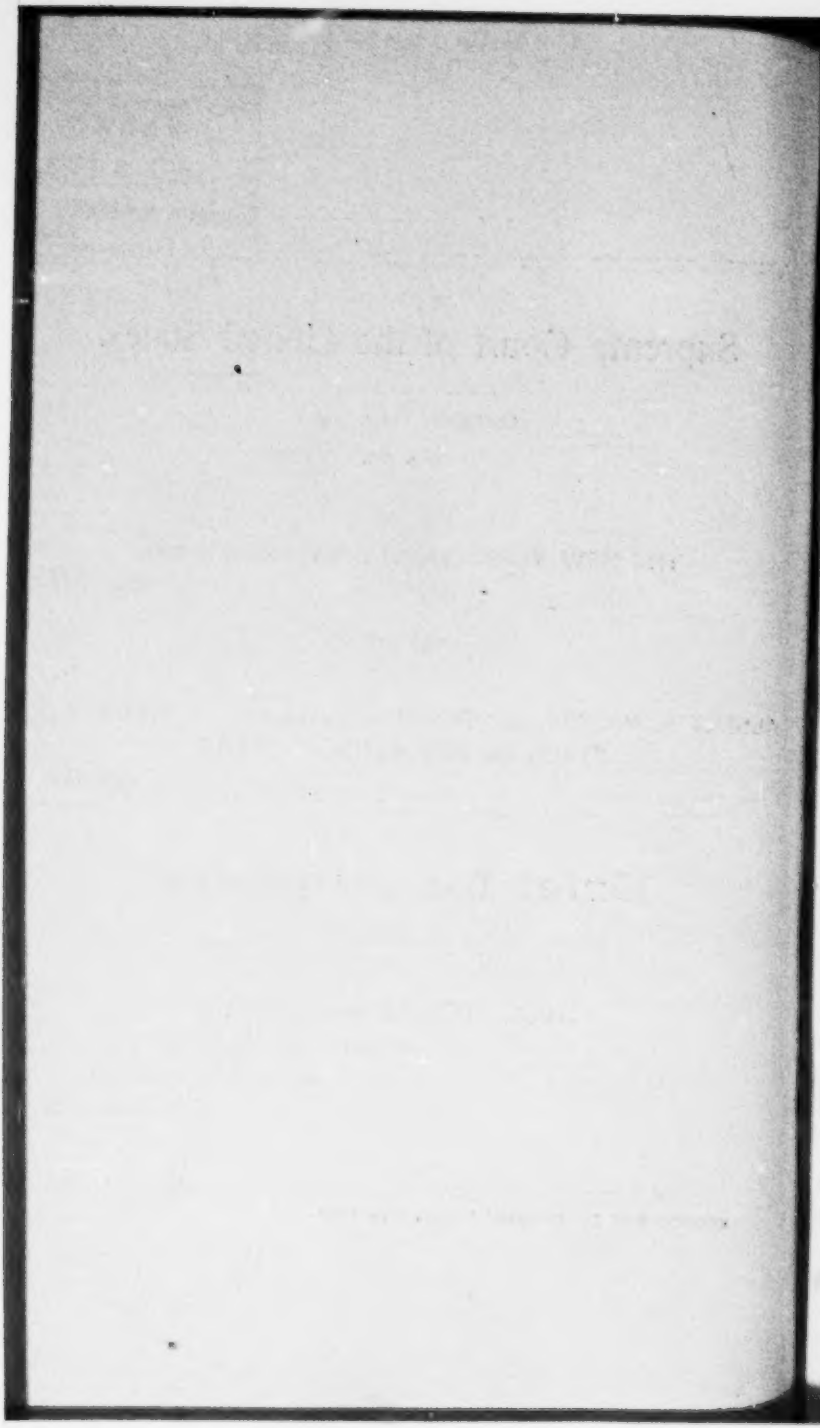

Supreme Court of the United States,

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No. 90.

THE NEW YORK COUNTY NATIONAL BANK,
Appellant,

AGAINST

ALBERT P. MASSEY, as Trustee in Bankruptcy of George H. Stege and Frederick H. Stege,
Appellee.

Statement.

This is an appeal (fols. 32 to 37) from an order of the Circuit Court of Appeals for the Second Circuit (fols. 30 and 31) reversing an order of the District Court for the Southern District of New York (fols. 14 and 15), which affirmed a ruling of the Hon. Peter B. Olney, Referee in bankruptcy (fol. 5), denying a motion of the Trustee in bankruptcy to expunge the claim of the New York County National Bank, unless it should first surrender an alleged preference received by it.

The case comes here upon findings of fact and

conclusions of law made by the Circuit Court of Appeals (fols. 24 to 29) in accordance with General Orders in Bankruptcy No. 36. These findings of fact are substantially identical with the facts contained in the Referee's certificate (fols. 8 to 12).

The bankrupts George H. Stege and Frederick H. Stege, under the firm name and style of Stege & Brother, were for a number of years engaged in the City and County of New York in the business of dealing, at wholesale, in butter, eggs, &c. They kept their bank account in the New York County National Bank. During the year 1899 they borrowed from the bank $40,000 in four separate installments of $10,000 each, for which they gave the bank four notes for $10,000 each, payable at various times in the latter part of 1899. None of these notes were paid when they fell due, but all of them were renewed. Two of the renewal notes fell due on January 26, 1900; the other two on February 9, 1900. Three days before the first two notes fell due, on January 23, 1900, in the morning of that day, the bankrupts went to the New York County National Bank and asked its officers to have these two notes extended or renewed. They informed the bank officers at that time that they were unable to pay the notes then about to fall due. In the afternoon of the same day, January 23, 1900, they again called at the bank, and at that time they delivered to it a statement of their assets and liabilities (fol. 4). This statement, as of January 22, 1900, showed that they were hopelessly insolvent, their assets being $19,095.67, and their liabilities $65,854.61.

On January 22, 1900, the bankrupts' balance in their account with the bank was $218.50. On that day they deposited $536 83. On the next day, January 23, 1900, they deposited $3,884.47. On January 25, 1900, they deposited $1,803.95, making a total deposit of $6,225.25 upon the three days mentioned.

On January 27, 1900, Stege & Brother filed a voluntary petition of bankruptcy in the District Court

for the Southern District of New York, with liabilities of $67,232.49 and assets of $20,729.66, and upon the same day they were duly adjudicated bankrupts. Upon the day of adjudication, January 27, 1900, there was left in the bank account in the New York County National Bank the sum of $6,209.25.

In due course of time, the New York County National Bank presented its claim against the bankrupts' estate for $33,790.25 (fols. 2 and 3). In this proof of claim the bank credited upon one of the notes for $10,000, which fell due on January 26, 1900, the deposit of $6,209.75. The Referee allowed its claim in the sum of $33,750.25, being $40,000 less the amount on deposit in the bank and less a small rebate for interest on the unmatured notes.

The trustee in bankruptcy contended that the bank had received a preference through the deposit and its appropriation by the bank in part satisfaction of one of the notes, and, therefore, should not be allowed to prove for the balance of its claim unless it first surrender the alleged preference. The Referee refused to expunge the claim, and his ruling was affirmed by the District Court. The Circuit Court of Appeals reversed the ruling of the Referee and the order of affirmance of the District Court, holding that the bank had received a preference. From that decision the New York County National Bank has appealed to this Court. The opinion of the Referee is printed at folios 11 and 12 as a part of his certificate; that of the District Judge at folio 13; that of the Circuit Court of Appeals at folios 20 to 23 (116 Federal Reporter, 342).

POINTS.

I.

The making of these deposits by Stege & Brother at a time when they were insolvent and their appropriation by the bank in part satisfaction of the debt owed it by Stege & Brother have given the bank a preference.

The statute (Section 60, *a*) provides:

> "A person shall be deemed to have given a preference if, being insolvent, he has * * * made a transfer of any of his property, and the effect of the enforcement of such * * * transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class."

So much of the statute as relates to "suffering a judgment to be entered, etc.," has been left out in the foregoing quotation. It should be noted, however, that the quotation from this section which is contained in the Referee's certificate (fol. 11) and also the one contained in appellant's Brief (p. 13) leaves out the words "of the enforcement"; it should be as quoted above: "and the effect of the enforcement of such transfer, etc.," instead of "and the effect of such transfer, etc."

Thus, it will be seen that there are three elements which go to make up what the Bankruptcy Law calls a "preference": (1) the condition of insolvency, (2) a transfer of the bankrupt's property, and (3) the effect or consequence of such transfer must be that the creditor who, it is claimed, has received such preference will, by reason thereof, receive a greater percentage of his debt than other creditors

of the same class. If these three elements are present, the statute declares that a "preference" has been given and received.

As to the first element, the condition of insolvency of Stege & Brother, nothing need be said. It is admitted that Stege & Brother were at the times when these deposits were made insolvent. The statement of assets and liabilities (fol. 4), which they delivered to the bank on January 23, 1900, and which gives their condition as of January 22, 1900, upon which day the first deposit involved in this case was made, shows a deficiency of assets by about $47,000. Ignorance of the fact of insolvency on the part of the bank on January 22, 1900, is, of course, immaterial.

Pirie *vs.* Chicago Title & Trust Co., 180 U. S., 438.

It is equally clear that the third element is present: If the bank is permitted to apply these deposits upon one of the notes owed it and may prove its claim for the balance, it will obtain a greater percentage upon its debt than other general creditors. As the matter stands now, the bank has received the entire $6,000, whereas, if it is required to surrender the deposits to the trustee in bankruptcy, it will have to share these deposits with all other general creditors. Thus, the only remaining question is whether the making of these deposits is a "transfer of property"; if it is, you have got all the elements required for a "preference."

One of the reasons why the Referee refused to expunge the claim of the bank without requiring it to surrender the deposit, was that, in his opinion (fol. 11), the making of a deposit is not a "transfer." The statute, in Subdivision 25 of Section 1, defines a "transfer" as follows:

> "Transfer shall include the sale, and every other and different mode of disposing of or parting with property or the possession of property, absolutely or conditionally, as a

payment, pledge, mortgage, gift, or security."

The learned Referee was of the opinion that the foregoing definition contained all the modes of "transfer" in the enumeration "sale, payment, pledge, mortgage, gift, or security," and that as a "deposit" was not so enumerated, it was not, therefore, one of the modes by which a "transfer" could be accomplished. This construction is too narrow. Assuming that Subdivision 25 of Section 1 is at all a *definition* as distinguished from a mere *description*, the definition proper ends with the word "conditionally." The remainder of the subdivision is only a recital of names of certain acts by which a "transfer" can be, and usually is, accomplished. This recital or enumeration is by no means exhaustive. It is merely illustrative of the more common forms of "transfer." There may be a great variety of other acts, known by different names, by means of which a "transfer" can be consummated. For this very reason the legislature has said in its definition:

> "The sale *and every other and different mode* of disposing of or parting with property or the possession of property, absolutely or conditionally, * * *"

The phrase *every other and different mode* includes any act or series of acts, no matter by what name it or they may be known, by which the ownership or the possession of property is transferred from a bankrupt to his creditor. That the legislature meant to make this definition as broad as possible is plainly evidenced by the insertion of the adjective "different" before "mode of disposing of or parting with." Evidently, this word was put in for a purpose, for without it the clause would have been construed, according to a well known canon of construction, "and every other *like* mode." The question is not by what name a given transaction

is called, but what is the substance of the transaction, rather than its form or the name attached to it. Undoubtedly, there are a great many acts by which a transfer of property might be accomplished, and yet you might not be able to call those acts by any one of the names which you find enumerated in subdivision 25 of Section 1. If this narrow construction must prevail, it follows that such comparatively common methods of transfer as a transfer by *assignment*, or *conveyance*, or *loan* is not a "transfer" within the meaning of the bankruptcy act. Our contention for a broad construction of the definition of "transfer" is supported by the opinion in Pirie *vs.* Chicago Title & Trust Company, 182 U. S., 438, 444, where Mr. Justice McKenna says:

> "Transfer is defined to be not only the sale of property, but 'every other mode of disposing of or parting with property.' All technicality and narrowness of meaning is precluded. The word is used in its most comprehensive sense, and it is intended to include every means and manner by which property can pass from the ownership and possession of another, and by which the result forbidden by the statute may be accomplished * * * a preference enabling a creditor 'to obtain a greater percentage of his debt than any other creditors of the same class.'"

It should be noted that the Referee's decision in this case was rendered before the Pirie case was decided in the Supreme Court. It is difficult to see why making a deposit should not come within this definition; it certainly is a transfer of property in the ordinary sense, viz., of money or checks (choses in action) by the depositor to the bank.

We have, therefore, a case in which all the elements which go to make up a "preference" are present: Stege & Brother were insolvent at the time the deposits were made; Stege & Brother made a transfer of some of their property to the bank; and

the effect of the transfer, if the bank is permitted to apply these deposits to wipe out a part of the debt owed it by Stege & Brother and to prove for the balance due on the notes, will be that it has received a greater percentage upon its debt than other creditors of the same class. Having received this "preference," Section 57,*g*, applies:

> "The claims of creditors who have received preferences shall not be allowed unless such creditors shall surrender their preferences."

II.

The bank having received a preference, the doctrine of set-off cannot be invoked to undo and to make good what the statute has declared is a "preference."

Section 68, *a*, provides:

> "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other and the balance only shall be allowed or paid."

There is nothing in this provision which tends to show an intention on the part of Congress to override by it the sections of the act relating to preferences. It is not a new provision. It was contained in the prior bankruptcy acts. The provision of the Act of 1867 (Section 20) was identical with the one in the present act. As stated in the opinion of Mr. Justice Miller in Sawyer *vs.* Hoag, 17 Wallace, 610, 622, in speaking of Section 20 of the Act of 1867:

> "This section was not intended to enlarge the doctrine of set-off or to enable a party to

> make a set-off in cases where the principles of legal and equitable set-off did not previously authorize it."

Thus, we have here a rule relating merely to the orderly administration of bankrupt estates, a mere rule of bookkeeping, as it were, which gives creditors of bankrupt estates the right to obtain the advantages of the doctrine of set-off as that has for a long time past been administered by our courts, especially by the Court of Chancery. That is all what was intended in the Bankruptcy Act. To insist that additional rights are given by this provision, viz., the right on the part of a creditor to nullify and to override by means of it the positive provisions relating to preferences contained in an act, the very purpose of which is to bring about a ratable distribution of the bankrupt's assets among his creditors and to avoid preferences as much as possible—is to write into it words that are not contained in it and to give it a meaning unwarranted by its letter or spirit. The construction insisted upon by the bank is an unreasonable one. It is claimed by the bank, in effect, that the correct construction of this clause is

> "in all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor, the account shall be stated and one debt shall be set off against the other, *even though the creditor by reason of such set-off shall acquire a preference over other creditors of the same class.*"

That is precisely what the claim of the bank is with regard to the construction of this clause. On the other hand, the trustee in bankruptcy contends that this clause should be construed in subordination and in harmony with the clauses relating to preferences; in other words, that it should be construed as if it read—

> "* * * and one debt shall be set off against the other, *provided, however, that no*

set-off shall be allowed if the allowance thereof would give such creditor a 'preference' over other creditors of the same class."

We submit that this is a more reasonable construction than the one put forth on behalf of the bank. It is a well-known canon of construction that a statute must be construed as a whole, and that in case a given clause in the statute is capable of two constructions, one of which would contradict other provisions of the statute, or tend to destroy the purpose and spirit of the statute as a whole, whereas the other construction would harmonize the several clauses of the statute, in that case the courts will adopt the latter construction. The avowed purpose of the Bankruptcy Act is to provide for equal distribution of the bankrupt's assets among all his creditors, and to that end to annul, as far as possible, any act, no matter by what name that act may be called, which tends to give one creditor an undue advantage over other creditors. All the provisions of the statute should be construed with this object steadfastly in view. The construction of Section 68, *a*, which the trustee contends for, harmonizes the several provisions of the statute, and is in direct line with the object and spirit of the whole act; the construction which the bank contends for strikes a death blow at the very purpose of the act. It should not be difficult for the Court to choose between these two conflicting constructions. Full scope and effect can be given to this section by construing it in subordination to the clauses relating to preferences. There is no reason why the Court should go beyond that. It is not true, as claimed in appellant's brief (Point I.), that every set-off involves a preference. Every set-off does not involve a preference as that term "preference" is defined in the bankruptcy act. It may be true that every set-off "necessarily involves the payment of the whole or some part of the debt in full," but that

is not the test of a "preference." That test is whether the creditor has received from the bankrupt at a time when the latter was insolvent a part of his estate which will enable the creditor, if he is allowed to prove for the balance of his claim without surrendering what he has received, to obtain a greater percentage of his debt than other creditors. Take the case at bar: a deposit made by Stege & Brother in this bank *at a time when they were not insolvent* would not be a "preference" within the meaning of the act. The bank would have a right to set it off against these notes by way of set-off, or it might appropriate it upon the theory that it had a banker's lien. So we have a case where there is a good set-off, and yet the creditor has not received a "preference." That, we claim on behalf of the trustee, is the legitimate scope of Section 68, *a*. Apply it to credits that have arisen to the bankrupt prior to his insolvency. If you go beyond it, you will permit "preferences" to be given indirectly, although you have declared that you will not permit it to be done directly by a payment on account.

If the construction contended for by the bank be sound, it might, by way of analogy, be contended that secured creditors can prove their claims for the balance due them in all cases even though the security which they received was obtained under circumstances which make it a preference. Section 57, *h*, provides, in substance, that the value of the securities held by a secured creditor shall be determined, and that he may then prove his claim for the unpaid balance and be allowed dividends thereon. There is nothing in this subdivision or in Subdivision 23 of Section 1 of the act defining the term "secured creditor" which limits the right to prove for the unpaid balance to secured creditors whose security is not at the same time a preference; yet it cannot be seriously contended that secured creditors whose security was acquired by way of preference can prove for the balance, without surrendering. Can a creditor to whom the bankrupt,

on the eve of bankruptcy and without a present consideration, has given collateral with a power of sale, sell the collateral and prove for the balance without surrendering what he has received? Everybody will readily answer this question in the negative. Yet, the learned counsel for the bank would argue that this secured creditor could prove for his balance because he is a "secured creditor" and Section 57, *h*, says plainly that all that the law requires is that his security shall be valued and then he may prove for the balance, and there is nothing in that subdivision or in Subdivision 28 of Section 1 which limits his right to prove for the balance to secured creditors whose security was not received by way of preference. If it is conceded that this clause must be construed in subordination and in harmony with the clauses bearing upon preferences and with a view to the general purpose and spirit of the act, why does not that apply equally as well to the clause relating to the allowance of set-offs?

It is a fair assumption that these deposits are the proceeds of merchandise sold by Stege & Brother. Suppose, that instead of making these deposits in the bank, Stege & Brother, upon the same date, sold $6,000 worth of merchandise to the bank *upon credit*. Would the Court permit the bank to set off this debt for $6,000 against the debt owed it by Stege & Brother and prove its claim for the balance without surrender? We think not. The learned counsel for the appellant has a good deal to say in his brief (Point II.) about the nature and character of a deposit, and he cites at length from decisions of this Court which, in effect, hold that a deposit is a species of "loan." We will assume that it is such. Assume, further, that Stege & Brother, while insolvent, had made to this bank a loan of $6,000; would the Court permit the bank to set off this loan against the one which Stege & Brother owed the bank and to prove for its balance without giving up what it had received? Certainly not.

The bank's contention is that once you have the

formal relation of mutual debts and credits, a set-off must be allowed, although the result of it will be a "preference." The very circumstance that a great many cases have been before the courts under the Act of 1867 involving the validity of a set-off where the formal relation of mutual debts and credits existed, is, in our opinion, evidence tending to show that the matter is not concluded by saying that you have the relation of mutual debts and credits. If the bank is right, why have the courts considered at all the question whether a set-off was good or bad? In those cases you always had mutual debts and mutual credits, and yet the courts would still insist upon writing long opinions upon the question of whether or not the set-off should be allowed. So, in Traders' Bank *vs.* Campbell, 14 Wallace, 87, 97, 98, the Supreme Court seemed to think that even if you had a case of mutual debts and credits, it would be a question of whether the set off could be allowed.

The key to the question whether a set-off should be allowed in a given case is probably contained in Sawyer *vs.* Hoag, 17 Wallace, 610, one of the leading cases decided by this Court. In that case the defendant was indebted to the plaintiff, who was an assignee, under the Bankruptcy Act of 1867, for a bankrupt corporation, upon unpaid subscriptions to the capital stock of the corporation. The corporation being in turn a debtor of the defendant upon a policy, the defendant claimed that he had the right to a set-off under Section 20 of the Act of 1867, which is identical with Section 68, *a*, of the present act. The set-off was denied on the ground, among others, that the unpaid subscriptions to the capital stock were a trust fund for all the creditors, and no set-off could be allowed. Apply that to this case. When Stege & Brother became insolvent, their assets became, in contemplation of law, a trust fund for all their creditors. The deposits, which the bank has received, were a part of this trust fund. If the bank had received

them with knowledge of the insolvency, that is, with knowledge that they were a part of a trust fund, they would have been obliged, upon the suit of the trustee, to pay them back into the trust fund. Not having had this knowledge, being innocent, as it were, the Bankruptcy Act will not compel the bank to pay back the deposits into the trust fund, but simply insists that the bank shall not participate in what remains of this trust fund without giving up what it has received out of it. In other words, it denies the bank a set-off against the trust fund. By reason of the insolvency of Stege & Brother, these debts are not debts in *the same right;* the one debt, to wit, the one which Stege & Brother owe the bank, is an ordinary debt, whereas the other debt, to wit, the debt which the bank owes to Stege & Brother for the deposits, for the "loan" so-called, is a debt which is owed to a trust fund, and, in fact, is a part of that trust fund. For that reason it must be paid in full to the trust fund if the bank wants to come in and share that trust fund equally with all the other creditors. When Stege & Brother became insolvent, their assets were no longer the assets of "Stege & Brother," but of "Stege & Brother, in trust for their creditors." These deposits came out of the assets owned not by "Stege & Brother," but by "Stege & Brother, in trust for their creditors"; the debt raised by the deposits was a part of these assets. Hence, it was not owing to "Stege & Brother" but to "Stege & Brother, in trust for their creditors"; whereas the debt due to the bank on the notes was incurred by "Stege & Brother" at a time when their assets did not yet constitute a trust fund for their creditors, viz., twelve months before the deposits were made. Such debts are not debts *in the same right*, and, therefore, cannot be set off the one against the other. A somewhat similar question arose in Pearsall *vs.* Nassau National Bank, 74 App. Div., 89, where, in disposing of a like contention of the defendant bank in that

case, the Court denied the right to a set-off in the following language:

> "The learned counsel for the appellant contends that under the Bankruptcy Act the right of set-off existed from the time the notes were discounted, citing sections 63 and 68 of the act (30 U. S. Stat. at Large, 562, 565). He points out that section 68, to quote his language, 'provides that in all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated, and one debt shall be set off against the other, and the balance only shall be allowed or paid,' and that section 63, also quoting the counsel's language, provides that 'the "debts" of a bankrupt which may be proved and allowed against his estate are a fixed liability, as evidenced by judgment or an instrument in writing absolutely owing at the time of the filing of the petition against him, whether then payable or not,' and hence he contends that the bank had the right of set off even if the notes had not fallen due before the bankruptcy proceedings were commenced. I think that those provisions must be interpreted as applicable to the proceedings in bankruptcy and to the incidental proof and allowance of claims, but not as intended to change the principles of set-off in actions (Munger *v.* Albany City National Bank, 85 N. Y., 580, 588, citing Sawyer *v.* Hoag, 17 Wall., 610). When the plaintiff was declared a bankrupt, there was no mutual debt or mutual credit as between him and the bank, for the reason that he had, before even the filing of the petition, parted with his title to the assignee for the benefit of his creditors, and the claim in effect was that of the creditors as against the bank."

The bank contends that the trustee in bankruptcy stands in no better position than the bankrupts themselves; that, as this would have been a good set-off against Stege & Brother, it must be good against their trustee in bankruptcy (Appellant's Brief, top of p. 29). This contention is not sound.

The trustee in bankruptcy possesses the rights of the bankrupts *plus the rights of all creditors.* These additional rights are (1) to set aside preferences in all cases where the recipient of the preference has guilty knowledge of it, and (2), as to creditors who have received their preferences innocently, to deny them the right of participation in the bankrupt's estate unless they first surrender their preferences. The same claim was made in Sawyer *vs.* Hoag, 17 Wall., 610, 619, but Mr. Justice Miller disposed of it in the following words:

> "He (the appellant) assumes that the assignee in bankruptcy is the representative alone of the corporation, and can assert no right which it could not have asserted. The weakness of the argument is in this assumption. The assignee is the representative of the creditors as well as the bankrupt. He is appointed by the creditors. The statute is full of authority to him to sue for and recover property, rights, and credits where the bankrupt could not have sustained the action, and to set aside as void transactions by which the bankrupt himself would be bound. All this, of course, is in the interest of the creditors of the bankrupt."

The appellant cites a number of cases in his Brief (pp. 15 and 16) in which transfers made at a time when the bankrupt was insolvent were upheld, cases of "exchange of values," the typical instance of which is the case where a bankrupt while insolvent buys merchandise for cash, and a laborious attempt is made by the learned counsel for the appellant to show that the transaction between Stege & Brother and the bank is likewise an "exchange of values," that is, that the bank got the deposits and Stege & Brother got a debt due them from a solvent debtor, the bank. It requires little argument to show that the cases are not alike. In the cases cited, including the case of Jacquin *vs.* Alden, decided at the last term of this court (189 U. S., 82), money is exchanged for goods of equal value. The latter

take the place of the money and afterwards are distributed among all the creditors as a part of the bankrupt's assets. The bankrupt estate is not diminished in any way; there is simply an exchange of values. In the case at bar, money or money's worth is given to the bank; Stege & Brother's bankrupt estate (if the bank is allowed to apply the debt which it owes for the deposits in part satisfaction of the debt owed it by Stege & Brother, either by way of set-off or under the claim of a banker's lien) gets nothing in return. The bank gets $6,000; of this, the other creditors do not get a share, whereas, in the other case, they do share in the merchandise which has taken the place of the money paid for it out of the bankrupt estate If in the case at bar, after receiving the deposit of $6,000, the bank had made Stege & Brother another loan of $6,000, the proceeds from which, of course, would have increased the bankrupt estate by just that much, then the cases would be parallel; as it is, they are entirely dissimilar.

If the appellant's construction of Section 68, *a*, be correct, then it follows that his theory of set-off or banker's lien applies also in cases where the bank had knowledge of the insolvency of the bankrupts; that is to say, Section 68, *a*, not only overrides and nullifies Section 57, *g*, but would also prevent a trustee in bankruptcy from recovering back such a deposit if it were received by a bank with knowledge that the depositor was insolvent, for Subdivision *b* of Section 68, which denies certain set offs received within the four months' period with knowledge of an intended preference, seems only to be intended to condemn the practice on the part of a solvent debtor of the bankrupt of buying up claims against him, and to have no reference to the debt owed by the solvent creditor to the bankrupt. To insist upon a construction of 68, *a*, so sweeping that it would in a great many cases nullify both Section 57, *g*, and Section 60, *b*, seems to us to be an absolutely untenable position.

A word or two should be said about the precedents on the question of a bank's right to set off a deposit against a debt owing to it from the bankrupt. In examining the cases decided under the Act of 1867, one important factor must be borne in mind: under that act a creditor could not be denied the right to prove for his balance unless in addition to the elements required under the present act, he had knowledge of the bankrupt's insolvency, or, at least, reasonable cause to believe that a preference was intended. The section which corresponded to our present Section 57, *g*, was Section 23; it read as follows:

> "Any person who after the approval of this act shall have accepted any preference having reasonable cause to believe the same was made or given by the debtor contrary to any provision of this act, shall not prove the debt or claim on account of which the preference was made or given, nor shall he receive any dividend therefrom, until he shall first have surrendered to the assignee the property, money, benefit, or advantage received by him under such preference."

That being so, it follows that under that provision no set-off could be denied to a creditor unless this additional element was present, whereas under the provision with which we are concerned "knowledge or reasonable cause to believe, &c.," are immaterial. Bearing in mind this difference, we find that in the cases in which under the Act of 1867 a set-off was allowed, it generally appears that the set-off was not a preference because there was no evidence of such "knowledge or reasonable cause to believe." So, in *ex parte* Howard, 2 Lowell, 487 (Appellant's Brief, p. 24), where a set-off was allowed, it does not appear whether the depositor, when the deposits were made, was insolvent, or when the deposits were made, or whether the bank had knowledge of the insolvency when they were made.

In *In re* Petrie, 5 Benedict, 110, it appears as a fact in the case that the bank had no knowledge or notice of the insolvency (p. 111).

In *In re* Farnsworth, 14 N. B. R., 148; 5 Bissell, 223 (Appellant's Brief, p. 24), it appears that when the drafts were deposited in the bank for collection, the depositor was in good credit and his insolvency was not known to the bank.

A great many of the other so-called set-off cases under the former act dealt with the question of permitting a set-off where that set-off had been bought up by the person who afterwards claimed the right to set-off, and those cases, therefore, do not bear upon the point involved in this case.

Hough *vs.* First National Bank of Fort Wayne, 4 Bissell, 349 (Appellant's Brief, p. 23), and Robinson *vs.* Wisconsin Bank, 18 Bankruptcy Reports 243, (Appellant's Brief, p. 24), in both of which it seems to have been held that a bank under similar circumstances had a right to receive and apply upon the debt owed it by a bankrupt a check of the bankrupt for the amount of his deposit in the bank, are in direct conflict with Traders' Bank *vs.* Campbell, 14 Wallace, 87, and must, therefore, be considered overruled by the latter case decided in this Court.

The precise point presented by the facts of this case seems never to have been passed upon under the Act of 1867 by the Supreme Court; it was touched upon, however, in the last mentioned case, Traders' Bank *vs.* Campbell. In that case it appeared that a bankrupt on the eve of his adjudication had drawn a check in favor of his bank for the amount of his deposit, to be applied by it to a note due from him to the bank. The Supreme Court held that it was a preference. In the course of the opinion delivered, the Court distinctly declared that it did not pass upon the question whether, if, instead of having received the bankrupt's check for the amount of the deposit, the bank had relied upon its alleged right of set-off, that contention could have been allowed or not. The Court says (pp. 97, 98):

> "* * * and if they had retained it and appropriated it as a set off against the debt of the bankrupt to them, an interesting question might have arisen as to their right to do so; * * *"

and again,

> "in this case, as in the other, if they had stood on their right of set-off, it might have possibly been available * * *"

No definite deduction can be drawn from the opinion as to what the decision of the Supreme Court would have been if the exact point had been involved; the chances are that the Supreme Court would have said (assuming, of course, that in that case there was the additional element required under the Act of 1867, viz., "knowledge or reasonable cause to believe, &c."), that, after all, the distinction between directly receiving a check from the bankrupt for the amount of the deposit and allowing the debt raised by the deposit to be set off against the debt owed by the bankrupt to the bank, was a distinction of form only and not of substance, and that, therefore, the same legal result must flow from either act, viz., it must be declared a "preference." Recurring to a point touched upon in the early part of this brief, it seems clear from the opinion of the Court in the case just mentioned, that it does not follow that a set-off will be allowed under the Bankruptcy Act just because you have the formal relation of mutual debts and credits, but that there may be considerations which will call for the denial of the right of set-off under the Bankruptcy Act despite the fact that there is the formal relation of mutual debts and credits. In this respect the opinion tends to support our construction of Section 68, *a*, viz., that it should be construed in subordination to the provisions of the act relating to preferences.

None of the cases which have arisen under the present act decide the precise point involved in the case at bar, with the exception of *In re* Kellar, decided by Judge Shiras in the Northern District of Iowa, and reported in 110 Federal Reporter, 348. In the case of *In re* Meyers, 99 Federal Reporter, 691 (Appellant's Brief, p. 21), it does not appear whether the deposits were made by the bankrupt at a time when he was insolvent. That, of course, is an essential element; if the condition of insolvency was not present the transfer could not work a preference. From the language employed in the opinion it would seem reasonable to infer that the deposits were made at a time prior to the bankrupt's insolvency. It is said in the opinion:

> "A deposit in the bank becomes upon the bankruptcy of the depositor, a security for, and payment *pro tanto* of, his liability to the bank by the operation of the law of mutual credits * * *."

It seems manifest that in that case the deposits were made either when the loan came into existence or while the depositor was solvent, for the Court certainly would not have sanctioned something which in its opinion is the same as giving security for the liability after its inception or making a part payment upon the liability while insolvent. If the Court is right in saying that a bank deposit is like giving security or like making a payment *pro tanto*, it seems clear that such security would be a preference if given while insolvent and subsequent to the inception of the loan, and, equally, that making a payment *pro tanto* while insolvent would be a preference.

With regard to the case of Meyer, 107 Fed. Rep., 86 (Appellant's Brief, p. 25), for aught that appears in the case, the deposits were in the bank when the debt came into existence or were made while the customer was solvent; moreover, the actual point

decided in this case, as well as in the case of *In re* Meyers, 99 Fed. Rep., 691, was not the point involved here, but was whether the Court had power to correct a mistake which had been made, and by reason of which, it was claimed, the banks in those cases had lost control over the deposits.

In re Hays, Foster & Ward Co., 3 N. B. N. & R., 301, was a case to recover back an alleged preference under Section 60, *b*, and not a proceeding under Section 57, *g*. It appears as the uncontradicted evidence in the case that the bank officers at the time when they appropriated the deposit, did not know of the insolvency; it also appears that the deposit ($2,000) had been in the bank for more than four months.

In Matter of Max Kalter, 2 N. B. N. & R., 264, (Appellant's Brief, p. 22), it does not appear when the deposit was made, and the actual point decided was that, assuming there was a right of set-off, the circumstance that the note of the bankrupt became due after the adjudication in bankruptcy did not make any difference.

Besides the case of *In re* Kellar (*supra*) two cases have been decided which seem to take the view for which we contend.

Matter of Tacoma Shoe & Leather Co., 3 N. B. N. & R., 9.

Matter of Erik A. Christensen, 3 N. B. N. & R., 231.

The appellant in his brief (p. 29) makes an attempt to weaken the decision of Judge Shiras in *In re* Kellar (*supra*), by pointing out the difference between that case and the case at bar, in that in the Kellar case the debt owed by the bankrupt to the bank was caused by overdrafts made while he was insolvent, whereas, in the case at bar, the debt due from Stege & Brother to the bank arose twelve months before. We fear the learned counsel for the appellant has got "from the frying pan into the fire." We submit that our case,

just by reason of that difference, is a much stronger one. In the Kellar case, the bankrupt's estate, at a time when by reason of his insolvency it had become a trust fund for the creditors, received something, a credit, money, from the bank (for that is what the overdrafts amount to), and if you allow the deposit to be applied by the bank, either by way of set-off or banker's lien, it turns out to be a mere "exchange of values," and, therefore, in that case it would not have been unreasonable to hold that it was not a preference under the authority of the decision in Jacquin *vs.* Alden (*supra*) and cases there cited; in the case at bar, on the other hand, the trust fund of "Stege & Brother, in trust for their creditors" has received nothing; hence our case is much stronger than the Kellar case.

III.

To say that the bank has a banker's lien does not save the transaction from being a preference under the Bankruptcy Act.

The appropriation of the deposits and their application in part satisfaction of the note owed the bank under the claim of a banker's lien, cannot improve the appellant's status. One complete answer by the trustee to this claim is to say that the bank may have its lien if it so desires, may apply the deposits upon the debt on the ground that it has a lien upon them, but the fact remains that the banker's lien has worked a "preference." Hence, if the bank wants to prove for its balance, it has to give up its lien. We have no quarrel with the cases cited in Appellant's Brief under Point III. We admit that when the note became due on January 26, 1900, the bank acquired a lien upon the deposits.

The cases cited by the learned counsel for the appellant set forth correctly the nature and character of a banker's lien, but we cannot see how that improves his case. Undoubtedly, this lien is as meritorious as a great many other liens, but it does not follow on that account that it can be upheld if it works a preference in a given case. There are many acts which the common law and the statute law sanction, and yet these same acts are condemned by the Bankruptcy Law. Almost all the States of the Union permit general assignments, and yet the Bankruptcy Act makes a general assignment an act of bankruptcy. Equally, a great many general assignment acts permit of preferences within certain limitations, and yet the Bankruptcy Act does not countenance such preferences. The matter is effectively dealt with in the opinion of Judge Shiras in the case of *in re* Kellar, 110 Fed. Rep., 348, 351, as follows:

> "The conclusion of the Referee that the payment of the overdrafts in the manner stated did not constitute the giving of a preference seems to be based upon the legal proposition 'that the bank had the legal right to apply the deposits to liquidate the indebtedness created by the overdrafts,' and in the brief of counsel are cited authorities in support of the proposition that the bank had a lien on the moneys deposited in such sense, that it had the right to apply the same in payment of any debt due it. Under the rules of the common law, this right doubtless existed, but the question is, What change has been made therein by the enactment of the Bankruptcy Act? It will be kept in mind that the indebtedness by way of overdrafts and the depositing of the several sums applied in payment thereof all occurred after the date of the insolvency of Kellar. If the latter, after his insolvency, had gone to the bank with $600 in money, and had in terms paid the same in discharge of the debt in regard to the overdrafts, can there be any question that such a payment would have constituted a

preference? The sums upon the overdrafts were debts due from the bankrupt, and the payment thereof, after the actual insolvency of the debtor, certainly gives the bank a preference over the other creditors without regard to the particular method by which the payment was brought about." * * *

We take issue, however, with the appellant as to the point of time when this banker's lien arose. Without quoting at length from any cases, we submit that it is absolutely settled (especially in the State of New York) that the lien of the bank does not come into existence until the debt to the bank becomes due. The very cases cited by the appellant bring out this point clearly.

Jordan *vs.* National Shoe & Leather Bank, 74 N. Y., 467.

Straus *vs.* Tradesmen's National Bank, 122 N. Y., 379.

Smith *vs.* Eighth Ward Bank, 31 App. Div., 6.

Meyers *vs.* New York County National Bank, 36 App. Div., 482.

People *vs.* St. Nicholas Bank, 44 App. Div., 313.

Pearsall *vs.* Nassau National Bank, 74 App. Div., 89.

There is nothing in the record before the Court showing that there was any special agreement in this case which gave the bank a lien upon the deposits at the time when made, as was the case in Hatch *vs.* Fourth National Bank, 147 N. Y., 184. If there had been such an agreement, the lien would have attached at the time when the deposits were made; in the absence thereof, there was no lien in this case until the first note of Stege & Brother for $10,000 became due on January 26, 1900. To insist that the lien arises at the time the bank makes the loan, is a claim unwarranted by the authorities. Even if we assume that there was a special agree-

ment made at the time the notes were discounted by the bank, it is amply settled by the authorities decided under the present bankruptcy law that the lien would not attach until actual possession took place.

Wilson Brothers *vs.* Nelson, 183 U. S., 191.

Matthews, as Trustee, *vs.* Hardt, 79 App. Div., 570.

Matter of Fannie Mandel, decided by Referee Dexter in the Southern District for New York, and affirmed by District Judge Holt on November 2, 1903, reported in the *New York Law Journal* for November 24, 1903.

The Bankruptcy Law (Section 67, *d*), preserves:

> "liens given or accepted in good faith and not in contemplation of or in fraud upon this act, and for a present consideration. * * *"

This banker's lien, acquired on January 26, 1900, was not acquired for a *present consideration*. No consideration whatever passed to the bankrupts in exchange for the deposits; their estate got nothing in return for them; no new credit was given by the bank to the bankrupts upon the strength of the deposits; the bankrupts were indebted to the bank for $40,000 before the deposits were made, and the amount of that debt remained unchanged after the deposits were made. The question of liens under the Bankruptcy Act is very ably dealt with in several decisions of Judge Brown in the Emslie cases, 97 Fed. Rep., 929, and 98 Fed. Rep., 707. The opinion of the Circuit Court of Appeals in the same case (102 Fed. Rep., 291) does not take issue with any of the statements made in this respect in Judge Brown's opinion (see also the opinion of Judge Lowell in *In re* Belding, 8 American Bankruptcy Reports, 718, 719). In the case at bar Stege & Brother owed the bank

$40,000. As security for it, on January 22, 1900, the bank had nothing but a deposit of $218.50; afterwards it received additional security of over $6,000; no present consideration whatever passed to Stege & Brother in exchange for that sum; their estate was that much worse off than before and received nothing to replace it. So far as the substance of the transaction is concerned, there is absolutely no difference, considering the effect of it (and that, we submit, is the test of whether a thing is a "preference" or not), between what occurred in this case and handing over to the bank collateral to the amount of $6,000 with a power of sale or giving the bank a check, or several checks, aggregating $6,000 on account of the debt owed it.

IV.

The order of the Circuit Court of Appeals should be affirmed, with costs and damages.

In view of the fact that the appellant has for several years tied up this bankrupt estate and kept the other creditors out of their money, it seems but fair that the Court should, in addition to costs, impose upon the appellant damages pursuant to Supreme Court Rule 23.

HILL, STURCKE & ANDREWS,
Attorneys for Albert P. Massey, as Trustee in Bankruptcy of George H. Stege and Frederick H. Stege, Appellee.

LOUIS STURCKE,
ALBERT P. MASSEY,
Of Counsel.

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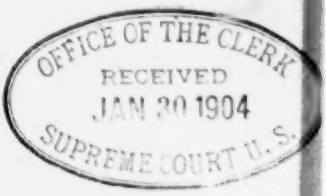

Supreme Court of the United States,

OCTOBER TERM, 1903.

No. 90.

THE NEW YORK COUNTY NATIONAL BANK,
Appellant,

AGAINST

ALBERT P. MASSEY, as Trustee in Bankruptcy of GEORGE H. STEGE and FREDERICK H. STEGE,
Appellee.

PETITION FOR REHEARING.

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Albert P. Massey, as Trustee in Bankruptcy of George H. Stege and Frederick H. Stege, respectfully presents his petition for a rehearing of this cause, and submits the following reasons why his prayer should be granted:

I.

Counsel for the appellee overlooked to call the attention of the Court to the circumstance that the

definition of the term "transfer" contained in Subdivision 25 of Section 1 of the Bankrupt Act is introduced by the words, "shall include"; that these words, "shall include" are words of enlargement and extension rather than restriction; that, accordingly, the term "transfer" as used in the body of the act (Section 60*a*) must be construed as comprehending not only such things as are enumerated in Subdivision 25 of Section 1, but also things which the natural and ordinary import of the term "transfer" would comprehend; that "transfer" of property in the ordinary and natural sense comprehends a transfer by way of deposit or loan; that, taking into account the entire Section 1, it appears that the Congress in some subdivisions of it advisedly used the term "shall mean" and in others "shall include"; that this theory of construction is strongly supported by reference to other subdivisions of Section 1, such as subdivisions 1, 22, and 24; that the attention of the Court should be drawn to the following cases in support of this construction:

Regina *v.* Kershaw, 6 E. & B., 999, 1006 (Erle, *J.*).

Queen *v.* Hermann, E. L. R., 4; Q. B. D., 284, 288 (Lord Coleridge).

Dilworth *v.* Commissioners of Stamps, Appeal Cases (1899) 99, 104, 105, 106 (Lord Watson).

II.

Assuming that a "transfer" must have the effect of a "payment, pledge, mortgage, gift, or security," counsel for appellee overlooked to call the attention of the Court to the circumstance that a transfer by way of deposit could without difficulty be held to be a transfer "as security," and thus be brought within the definition.

III.

The Court fell into error in relying upon cases of bank deposits decided under the Act of 1867; that it appears that in the cases cited no attempt was made to impeach the set off claimed on the ground that it was traceable to a transfer which worked a preference; that it does not appear in any of the cases relied upon that the bank which claimed the set-off had knowledge of the insolvency of the depositor when the deposit was received, or reason to believe that he was insolvent; that under the Act of 1867 a set-off could not be attacked on the ground that a preferential transfer had been received unless the recipient thereof had knowledge or reasonable belief of insolvency of the bankrupt; that, accordingly, the cases cited are not authorities for the decision in the case at bar.

IV.

The Court fell into error in holding that a transfer in order to be the basis of a preference, must diminish the bankrupt's estate *at the moment when the transfer is made*, and that in a case of a deposit or a loan there is no such diminution, because when it is made a debt arises on the part of the bank or borrower to the bankrupt to repay the money deposited or loaned (see paragraphs of opinion on page 4, beginning with "The law requires, * * * &c."). Your petitioner respectfully submits that the test applied by the Court is not a correct one: a "sale" may under subdivision 25 be a transfer leading to a preference. The Congress could not have meant a sale *for cash*, because that would be a simple "exchange of values"; consequently, it must have had reference to a sale *on credit* made after the vendor has become insolvent. In the latter case only could a preference result from a sale. Thus, there would be a preference although the estate of the bankrupt

is not diminished at the moment when the sale is made any more than in the case of a deposit or loan; and, equally, at the time when the sale is made a debt arises due from the vendee to the estate of the bankrupt just as in the case of the deposit or loan. It is submitted that the test is, what is the ultimate result of the transfer upon the bankrupt's estate; what is the ultimate result of the *enforcement* (see Section 60*a*) of the transfer, without regard to whether or not the estate is diminished at the mo ment the transfer is made. Support for this test is found in the presence of the words "the effect of the enforcement of such transfer * * *" in Section 60*a*, and also in Section 57*g*, the reading of which clearly indicates that the point of time when to inquire whether a preference has been received is at the moment when the creditor comes into court to prove his claim and asks to have it allowed.

It is also submitted that the only difference between the case of a payment of money, as referred to on page 5 of the opinion, and a deposit which is permitted to be set-off, is that in the former case the transfer is absolute and complete and is applied at once upon the debt due from the bankrupt, whereas in the latter case the application upon the same is not made until the set-off is had, but the result to the estate of the bankrupt is identical: in either case his estate is diminished by the amount of the transfer. In the case of a payment on account, the bankrupt, as the Court points out, receives nothing but a credit for the amount of his debt; in the case of a deposit, the bankrupt momentarily holds an obligation of the bank, but when the set-off is made, that obligation is wiped out, and then he has no more than in the other case, to wit, he receives a credit for the amount of his debt.

V.

The Court fell into error in holding that "if this argument (appellee's; Opinion, top of p. 5) were to

prevail, it would in all cases of insolvency defeat the right of set-off, &c." Your petitioner submits that the right of set-off would remain intact in all cases except those where the set-off is a debt which has arisen in favor of the bankrupt by reason of a transfer made by him after he has become insolvent. In no other case could a set-off be attacked on the ground that it worked a preference. In this respect a set-off would be in the same position as a payment on account: a payment on account made at a time prior to insolvency is perfectly good, and so is a set-off traceable to a transfer (by way of sale on credit, loan, deposit, &c.), made at a time prior to insolvency.

VI.

Your petitioner respectfully submits that the decision rendered on January 4, 1904, is of far-reaching significance and effect and applies equally well to the law as it stands since the amendment of February 5, 1903; that the Court, having held that a deposit is a loan payable on demand, and that such a loan is not a "transfer," it follows that any bankrupt, although insolvent, may give his creditor a preference *in fact* by lending him money, thus creating the relation of mutual debtor and creditor and making the set-off clause available, the only limitation being, as intimated in the opinion of the Court, collusion and fraud between the bankrupt and creditor. Mere knowledge on the part of the creditor that the bankrupt at the time when the loan or deposit was made was insolvent is not sufficient to invalidate the transaction, because that question must be deemed settled by the decision rendered in the case at bar, as it appears from the findings of fact that the last deposit of $1,800 was made two days after the bank had received positive knowledge of the insolvency of Stege & Brother.

Your petitioner therefore respectfully prays that this cause be restored to the docket and a reargu-

ment be ordered, and that the mandate herein may be stayed until the disposition of this petition.

ALBERT P. MASSEY,
as Trustee in Bankruptcy of George H. Stege and Frederick H. Stege.

The undersigned, a member of the bar of your honorable court, certifies that in his opinion the foregoing petition is well founded and is not made for the purpose of delay.

NEW YORK, January 29, 1904.

LOUIS STURCKE,
Of Counsel for Appellee.